



LOUISIANA DEPARTMENT OF THE TREASURY
ANNUAL REPORT :: FISCAL YEAR 2003 ::



PREPARED BY:
JOHN KENNEDY, STATE TREASURER

TREASURER'S LETTER



TO THE HONORABLE KATHLEEN BABINEAUX BLANCO, GOVERNOR OF LOUISIANA,
THE MEMBERS OF THE LEGISLATURE, AND THE PEOPLE OF LOUISIANA:

Fiscal Year 2002-2003 (FY2003) was more than just another year for me; it marked the completion of my first term as Louisiana's state treasurer. I am very proud of the things we at the Treasury have accomplished over the past four years: selling 60 percent of our tobacco settlement and placing \$1 billion into a trust for our kids and grandkids; returning more than \$50 million in unclaimed property to its rightful owners; developing the

Louisiana Teachers HomeBuyer Program; aggressively expanding and improving Louisiana's START College Savings Program; and safeguarding the taxpayers' hard-earned money during these challenging economic times.

But there's much more to be done.

We must make the right decision about selling the remaining 40 percent of our tobacco settlement so that we fully safeguard our education, healthcare and TOPS dollars. We must continue to look for innovative ways for state government to operate smarter and more efficiently. We must improve our state bond rating further so that the nation and the world will know that Louisiana is a place where businesses can flourish and families can prosper.

Last year, the state's bond rating was upgraded by all three rating agencies at a time when many other states were experiencing a downgrade. However, we still have room to improve.

During my time as treasurer, I have learned so much about Louisiana, its people and its promise. I commit that I will work with you and all of our state leaders to face the challenges before us with dedication, integrity and honor.

The taxpayers of Louisiana deserve no less.

Sincerely,

A handwritten signature in dark ink that reads "John Kennedy". The signature is fluid and cursive, with a long horizontal line extending from the end.

John Kennedy
State Treasurer

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ABOUT THE ANNUAL REPORT

Each year, we email the *Annual Summary on the Financial Condition of the State* to the governor and members of the Legislature before the start of the regular legislative session. The general public can view and download this publication at www.latreasury.com.

For this year's report, in addition to looking back on our annual investment figures, performance and programs for FY 2003 (which ended June 30, 2003), we especially want to increase the public's awareness about the State Treasury and what services it offers to Louisiana taxpayers.

OUR MISSION



The mission of the Department of the Treasury is to manage state funds by promoting prudent cash management and investment strategies as well as monitoring, regulating and coordinating state and local debt obligations as mandated by the Constitution and the laws of the state of Louisiana.

ABOUT THE TREASURER

John Kennedy—Treasurer of the state of Louisiana

John Kennedy was elected to his second term as State Treasurer on October 4, 2003, and was the only statewide elected official to take office without opposition. He was first elected Treasurer in 1999 when he unseated the incumbent with 56 percent of the vote.

Kennedy manages the state's \$5 billion bank account including the investment of \$3 billion in trust funds. He oversees all local and state bond issues, returns millions of dollars in unclaimed property each year, and takes care of state fiscal matters. He works diligently to guard taxpayers' money and rejects the status quo when it is not in the best interest of the state.

Kennedy spearheaded the sale of 60 percent of the state's tobacco settlement and placed \$1 billion in trust funds for healthcare, education and the TOPS scholarship program. Louisiana is one of the only states that protected its tobacco monies. Many others used their settlements to plug budget holes or pay for recurring expenses.

A proponent of education, Kennedy encouraged Louisiana school districts to put the money they received from the tobacco sale into trust funds for pre-K education. He also helped teachers in Louisiana by offering \$20 million in home loan programs (available through the Treasury and the Louisiana Housing Finance Agency) with low interest rates or down payment assistance. He is an adjunct professor of constitutional law at LSU Law School and is a volunteer substitute teacher for East Baton Rouge Parish public schools.

Prior to his position as Treasurer, Kennedy served as Secretary of the Louisiana Department of Revenue from 1996-1999. As Secretary, he was responsible for returning more than \$22 million in unclaimed property to over 50,000 Louisiana citizens. He also made tax time easier for all Louisiana citizens by reducing the number of sales tax returns small businesses must file and by returning state tax refunds faster than ever before.

Kennedy's public service includes Special Counsel to Governor Buddy Roemer from 1988-1992 and Secretary to the Governor's cabinet from 1990-1992. He was a member of Governor Roemer's Commission on Medical Malpractice and the Secretary of State's Commission on Corporations.

His private sector work includes a civil litigation practice as an attorney and partner in the Baton Rouge and New Orleans law firm of Chaffe, McCall, Phillips, Toler and Sarpy, L.L.P. He received his Juris Doctorate in 1977 from the University of Virginia, where he was executive editor of the *Virginia Law Review* and inducted into the Order of the Coif. He is a first class honors graduate of Oxford University, where he received a B.C.L. degree in 1979.

Kennedy completed his undergraduate studies at Vanderbilt University where he was president of his senior class, elected to Phi Beta Kappa, and graduated magna cum laude in political science, philosophy and economics. He is a native of Zachary, Louisiana, and is an alumnus of Zachary High School, where he earned co-valedictorian honors in 1969.

The Treasurer serves on 29 state and national boards and commissions, including five state retirement systems, the Interim Emergency Board, the Louisiana Tax Free Shopping Commission, the Louisiana Tuition Trust Authority, and the Louisiana Lottery Corporation. He is chairman of the Public Retirement System Actuarial Committee, president of the Louisiana Asset Management Pool, chairman of the Old State Capitol Advisory Board and a member of the board of directors of the Louisiana Workers' Compensation Corporation. He is a past member of the board of directors of the Council for a Better Louisiana and the board of directors of the Institute for the New Orleans Center for Creative Arts.

Kennedy has published articles in the *Louisiana Law Review*, the *Tulane Law Review*, the *Louisiana Bar Journal* and the *Akron Law Review*.

He resides in Madisonville, Louisiana, with his wife, Rebecca Ann Stulb Kennedy, who is also an attorney and special magistrate, and their son, Preston, who is eight years old. They are members of the North Cross United Methodist Church.

STATE TREASURER'S OVERVIEW

State Treasurer John Kennedy is a constitutional officer and a statewide elected official who serves a four-year term. He serves as the state's banker and chief investment officer and is responsible for the smart management of state funds.

Some of Treasurer Kennedy's accomplishments for FY 2003 include:

Investments and Money Management

- Managing the state's cash flow, which exceeded \$19.9 billion.
- Generating \$121.1 million in investment earnings on the state's three major trust funds and earning a rate of return of 12.1 percent for the Louisiana Education Quality Trust Fund (LEQTF). In addition, the LEQTF received \$18.7 million in royalty income.
- Yielding 4.09 percent on the Millennium Trust Fund and 4.94 percent for the Medicaid Trust Fund.
- Managing (as chair) the Louisiana Asset Management Pool's investments, which had a rate of return of 1.23 percent for the fiscal year and total investments of \$1.26 billion.
- Working with The Vanguard Group to provide START account owners with a variety of equity options to diversify their investments.

Unclaimed Property

- Collecting \$27.6 million in unclaimed property from Louisiana businesses and refunding a record \$12.9 million. Louisiana's program is recognized as one of the best in the nation and has been featured twice on national television.
- Educating Louisiana business owners about their responsibilities under Louisiana's Unclaimed Property Law by sponsoring informational seminars and by hosting Treasury's first-ever unclaimed property amnesty program.

Financial and Consumer Services

- Assisting in the launch of LouLease, a \$50 million lease-purchase homeownership opportunity that will enable hundreds of Louisiana citizens to buy homes even if they have poor credit.
- Increasing financial literacy by assisting Sen. Paulette Irons and the Louisiana Jump\$tart Coalition in the passage of legislation to mandate personal finance instruction in Louisiana public high schools.

Social Security

- Supporting changes to federal social security law so that pension benefits will no longer be reduced for countless Louisiana citizens. Changes include eliminating the Windfall Elimination Provision and Government Pension Offset.

- Supporting federal legislation and subsequent state legislation (2004 Legislative Session) that will enable Louisiana to join more than 20 states in holding divided referendums for Medicare coverage for their public employees.

Certificates of Deposit

- Bidding out \$100 million in FY 2003 in online certificates of deposit as a way to increase economic development statewide and to give banks access to cash for lending purposes.
- Increasing the securities available for banks that lacked the collateral needed for certificates of deposit to include deposit guaranty bonds.

Bond Issues and Refinancings

- Approving (as chair of the State Bond Commission) over 220 bond issues (including re-financings), the proceeds of which were used to build and improve infrastructure, create thousands of Louisiana jobs, provide affordable education, and save over \$128 million for taxpayers.

The functions and offices of the State Treasury are outlined in their entirety in the subsequent pages of the annual report.

TREASURY OPERATIONS

THE LOUISIANA TREASURY

BANKING & INVESTMENTS

RECEIPTS
(MONEY IN)

EXAMPLES:

- State Tax Dollars
- Fees
- Federal Dollars

THE TREASURY PERFORMS THE
FOLLOWING ROLES:

- 1. Banking**—checking and savings accounts for the state of Louisiana and its agencies.
- 2. Accounting**—allocating money and earnings to one of the 300+ special funds.
- 3. Investment Management**—buying bonds and stocks to earn interest dollars on money saved or kept in the Treasury.

THE TREASURY IS JUST LIKE THE STATE'S OWN BANK, PLUS A FEW EXTRA SERVICES! WE SAFEGUARD DEPOSITS AND EARN INTEREST WHILE THE MONEY IS WITH US AND TRACK THE DAILY FLOW OF CASH IN AND OUT.

DISBURSEMENTS
(MONEY OUT)

EXAMPLES:

- State agency operation & payroll
- Payment of vendors
- Providing public services (healthcare, law enforcement)

BOND COMMISSION
(FUNDRAISING)

THE BOND COMMISSION RAISES CAPITAL FOR PUBLIC PROJECTS BY ISSUING DEBT IN THE FORM OF STATE BONDS.

FACTS ABOUT THE TREASURY:

- It cost \$3,366 per hour to operate the Treasury in FY 2002-03, and the Treasury earned \$117,350 per hour in investment income in FY 2003.
- Treasury managed an average of \$5.5 billion in monies in FY 2003.
- Treasury's General Fund investment portfolio's cumulative income reached the \$3 billion mark in June 2003.
- Treasury is the smallest staffed state department with 55 employees.
- Treasury managed over 313 statutory and constitutionally created funds in 32 separate investment portfolios earning \$244.1 million in FY 2003.
- Treasury utilizes a central cash management pooling concept to gain maximum investment of monies in Treasury. Through the centralized pooling of deposits, Treasury processed over 4.7 million deposit items and 73,000 credits totaling over \$19.9 billion in FY 2003.
- Treasury managed 14 General Obligation debt issues with debt service of over \$299 million in FY 2003.

UNCLAIMED PROPERTY (UCP)
(LOST & FOUND)

THE UCP DIVISION FINDS LOST OR FORGOTTEN MONEY BELONGING TO LOUISIANA CITIZENS & BUSINESSES AND WORKS TO RETURN THE MONEY TO ITS OWNER(S).

UNCLAIMED PROPERTY

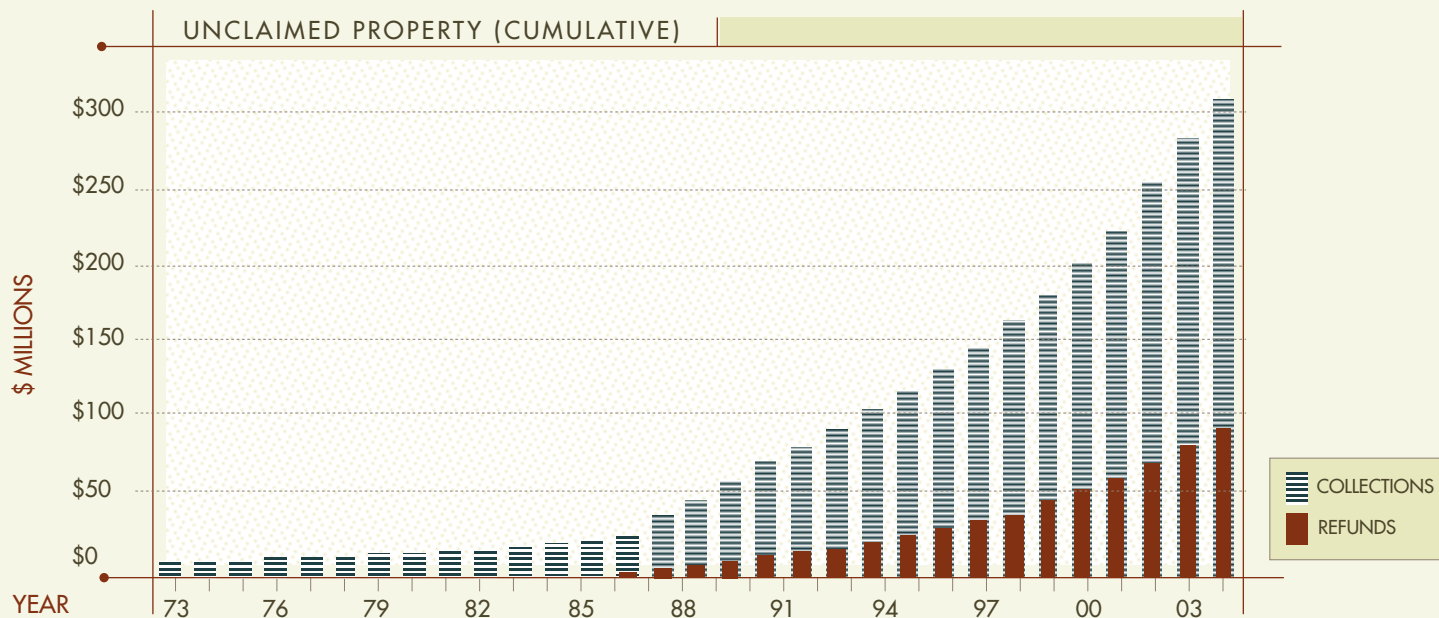
The Louisiana Department of the Treasury's Unclaimed Property Division is responsible for finding owners of unclaimed, intangible personal property that has been turned over to the state. This includes payroll checks, checking and savings accounts, royalties, utility deposits, interest, dividends, stock certificates and life insurance proceeds.

One in six people in Louisiana has unclaimed property listed with the state, and the average refund is \$200 to \$300, although some amounts are in the thousands, even millions.

There is no fee for collecting unclaimed property through the Louisiana Department of the Treasury, and there is no expiration date for making a claim.

With the support and assistance of the Louisiana Legislature, and because of continued efforts to increase the public's awareness about the program, the state has returned over \$91.8 million since the unclaimed property law was passed in 1972.

In an effort to return even more money to Louisiana citizens, the Unclaimed Property Division expanded its toll-free number nationwide, and now citizens across the United States can see if the state is holding their money by calling 1-888-925-4127. The Division's user-friendly website (www.latreasury.com) and online claim feature has generated more than 9,129 claims totaling \$5.1 million since its inception. In addition, the website received and processed 2,663,120 online searches for FY2003.



THE LOUISIANA ECONOMY AND GENERAL INVESTMENT CLIMATE

During FY 2003, Louisiana was in the midst of a lagging national economy and a still somewhat unsettled investment climate. Leading economic indicators were mixed, and talk of a jobless recovery abounded. The nation went to war with Iraq in 2003, and although it ended quickly, peacekeeping and rebuilding activities have continued into 2004. Also in 2003, just as the dust seemed to be settling from stock market scandals, the mutual fund industry was rocked with allegations of faulty business practices. During calendar year 2002 – the worst year of the recession – the state lost 17,700 jobs. Job loss decelerated across the nation in 2003, and Louisiana is estimated to lose about 2,800 jobs during that calendar year.

Although Louisiana suffered through the recession like other states, it fared much better than most and was able to handle shortfalls in state revenue. Luckily, the oil and gas exploration sector bolstered the economy and the relatively smaller amount of durable goods manufacturing in the state helped lessen the recession. Consumer spending and a strong housing market were two factors that helped keep the recession from being any worse nationwide.

However, the last two quarters of calendar year 2003 saw a number of economic indicators swing up, with consumer and investor confidence on the rise and Gross Domestic Product making huge strides. At the time of this publication, the stock market was trading again above the 10,000 mark and the American economy seemed to be again on the brink of a healthy expansion. Adding to the positive news, inflation and interest rates remain low.

The *Louisiana Economic Outlook 2004–2005* by Drs. Loren C. Scott, James A. Richardson and A.M.M. Jamal (published in September 2003) is an excellent summary of Louisiana's past economic condition and forecasted performance for calendar years 2004 and 2005.

Here is a summary, including excerpts, of the key points from this year's report:

Over the calendar year 2004–2005 period, Louisiana is once again forecast to enter a growth mode in the economy, adding up to 41,600 jobs over the two-year period. This translates to about 1.1 percent growth a year, but this rate will vary across different industrial sectors.

There are a number of key “drivers” of the economy that will be shaping things to come in 2004–2005. First, the national economy will continue to pick up and should produce annual growth rates of 3.8 percent and 3.4 percent a year for 2004 and 2005. Second, inflation will return mildly but will still result in a relatively low rate. Third, the exchange rate of the U.S. dollar will continue to drift downward, helping our export sales. Fourth, oil prices are expected to fall slightly to the \$24–\$26 a barrel range. And fifth – and perhaps most important – natural gas prices will continue to remain high in the \$5.50–\$5.60 per mmBTU range. Many economists agree that this is not just a typical cycle of high natural gas prices, but a more permanent structural shift until a very substantial and steady additional supply of natural gas is established for the United States.

Because of these high natural gas prices, the chemical industry will continue to be troubled, losing about 1,800 more high-paying jobs over the 2004–2005 period. Paper, food processing and refining will also experience losses, but the healthy transportation equipment sector will help offset some of the decline with the GM plant in Shreveport and the military-contract-driven shipbuilding industry.

And finally, the oil and gas extraction sector should add about 2,000 jobs as the industry begins to respond to the high natural gas prices.

The construction sector was hardest hit by the recession, and the weakening chemical sector will continue to drag employment down. However, several other large construction projects throughout the state will help this sector recover some of these jobs over the next two years.

With many industrial sectors projected to improve with the economy over the next two years, the feeder sectors (such as healthcare, leisure/hospitality, transportation/warehousing, education services, professional and business services, and retail and wholesale trade) should return to much better growth as well.

And because Louisiana received a weaker hit from the national recession than other states, its rank in per capita income among the 50 states improved from 45th to 41st between 2001 and 2002 to \$25,446 – better than most of our southern neighbors. Outmigration, however, continues to be a serious problem in Louisiana, causing our projected population growth to be about 0.3 percent a year.

BUDGET AND STATE SPENDING

The Louisiana economy through the past couple of years continued to be somewhat weak in FY 2003. This is reflected in the *Louisiana Comprehensive Annual Report for the Fiscal Year Ended June 30, 2003* (CAFR) by the overall reduction in the general revenues of the state (excluding federal sources) of \$369 million.

For the first time in eight years, funding from grants and other contributions exceeded income from taxes as collections from both income and sales taxes (the two largest single contributors to state tax revenues) dropped by \$470 million when compared to the previous fiscal year. This reduction in taxes was offset by an increase in funding from \$6.2 billion to \$6.8 billion in grants and contributions (including federal sources).¹

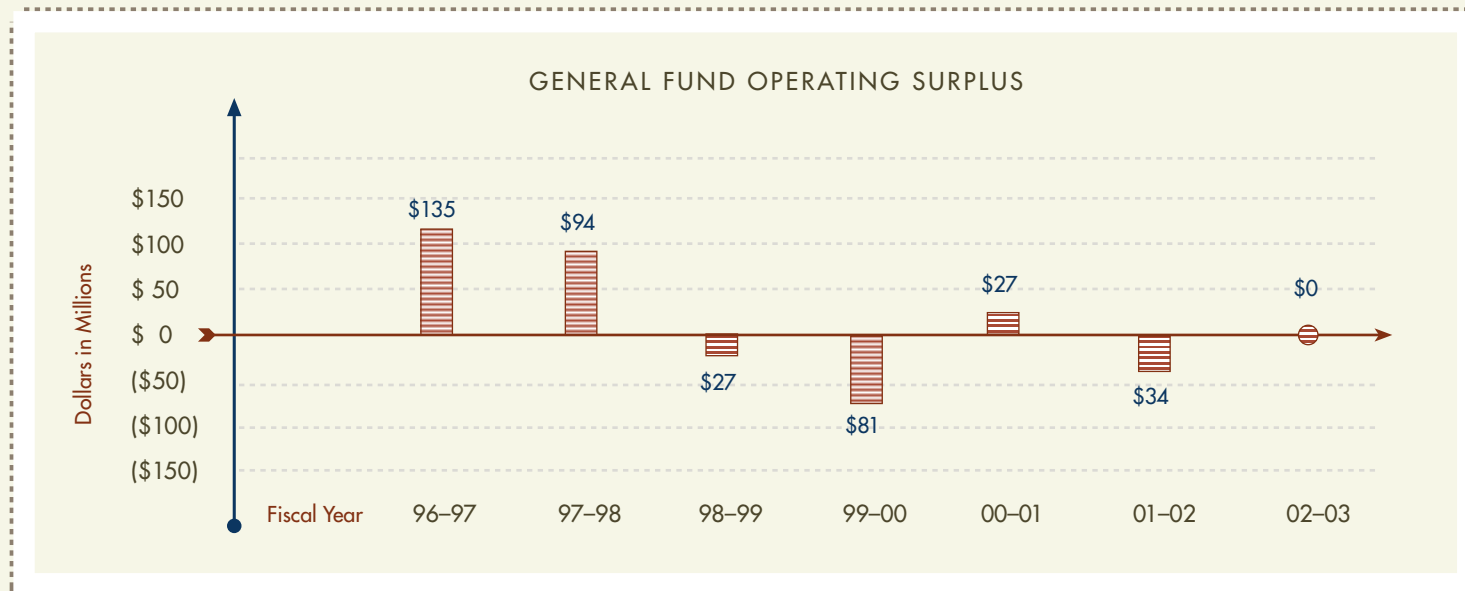
In non-taxable revenues, royalty income and gaming revenues from video draw poker devices increased slightly from the previous fiscal year.¹

The Treasury's investments program contributed \$61.2 million in non-taxable revenues for the General Fund. This reflects a cash rate of return of 4 percent in a short-term investment portfolio when compared to the benchmark thirty-day Treasury Bill average rate of 1.28 percent during the same time period.

On the expenditure side, state expenditures in FY 2003 were \$17.2 billion as compared to FY 2002 of \$16.3 billion. Expenditures increased in most areas of services to citizens but most notably in the area of education and general government.

The graph below, "General Fund Operating Surplus," reflects a \$0 undesignated fund balance for FY 2003 which represents a \$34 million improvement from the FY 2002 negative undesignated fund balance.

¹ Source: *Louisiana Comprehensive Annual financial Report for the Fiscal Year Ended June 30, 2003*.



CASH FLOW AND INVESTMENTS



The cash deposited into the General Fund and the cash disbursed from the General Fund vary month-to-month during the fiscal year. The Legislature has provided a way to ensure that the state pays its obligations timely during the months where the cash disbursed from the General Fund exceeds the cash deposited into the General Fund. This is called interfund borrowing. The General Fund temporarily borrows cash from a group of special funds in the Treasury. The total cash balance in these special funds is called the interfund borrowing base.

The “Interfund Borrowing Base” chart on page 11 depicts the total cash available for borrowing by the General Fund at the end of each month of the fiscal year. As depicted, the General Fund has a large pool of cash available each month to meet its cash borrowing needs.

The “General Fund Month-End Cash Balance” chart on page 12 depicts the cash balance of the General Fund at the end of each month. Points on the line graph below

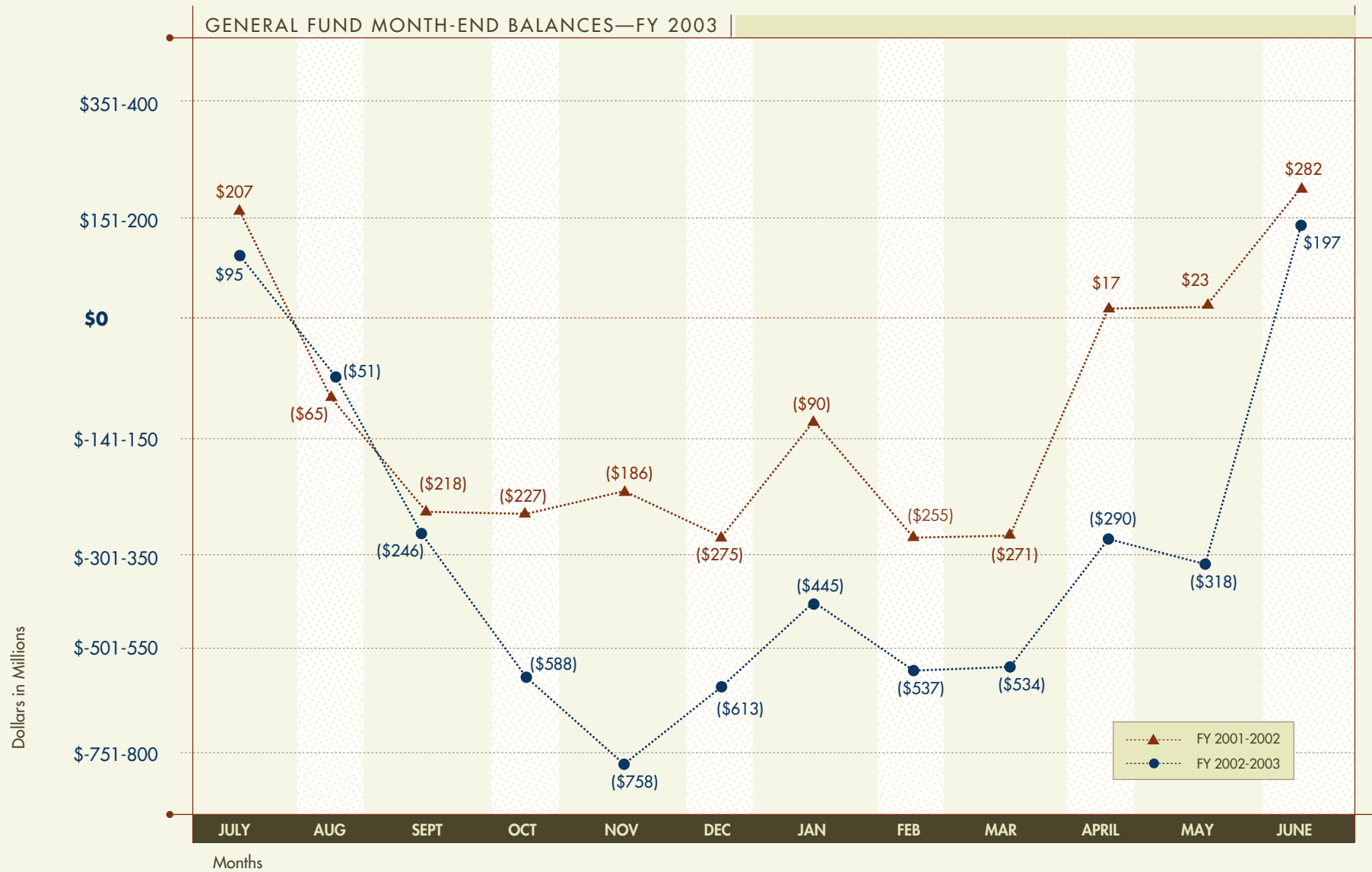
the \$0 line reflect the amount of cash borrowed by the General Fund at the end of the month. Points above the \$0 line reflect that the General Fund has a cash balance; thus, no interfund borrowing is required at the end of that month.

The legislation authorizing interfund borrowing requires that all borrowing be repaid by the close of the fiscal year. This requirement ensures that the General Fund does not spend money it will not collect in that fiscal year.

The chart reflects that all interfund borrowing that occurred during FY 2003 was repaid by June 30, 2003, the close of the fiscal year.

The Treasury monitors the state’s cash position on a daily basis. The information gained from this monitoring is linked to the state’s investments program, which assists the Treasury in gaining the highest available rate of return on its cash resources.





Sources: Advantage Financial System (AFS), the state's centralized accounting system.

For FY 2003, the Treasury earned \$107.5 million on its investments in the General Fund investment portfolio.²
 These earnings represent a 4 percent return on the average assets available for investments during the fiscal year.³



Source: Advantage Financial System (AFS), the state's centralized accounting system.

² Advantage Financial System (AFS), the state's centralized accounting system.

³ Calculation prepared by the Louisiana Department of the Treasury.

LOUISIANA EDUCATION QUALITY TRUST FUND

The fixed-income and equity investments of the Louisiana Education Quality Trust Fund (LEQTF) earned a 12.1 percent total rate of return for FY 2003⁴. Total return is a time-weighted measure of actual income received during the year, plus accrued income and any change in the price of portfolio securities and cash at the end of each year.

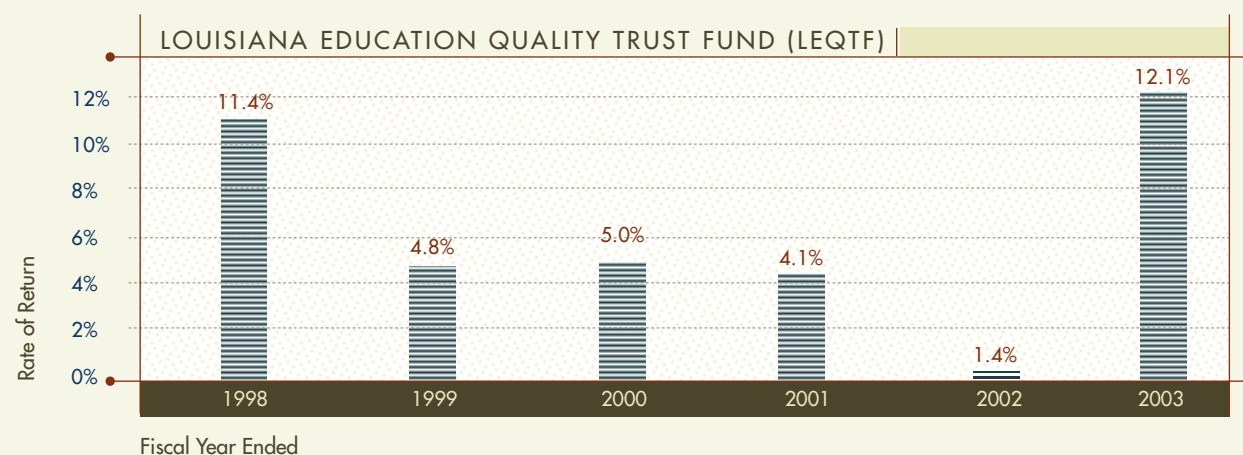
Act 802 of the 1990 Regular Session of the Legislature requires that investment earnings of the LEQTF be measured against the two-year U.S. Treasury Note and the 30-day U.S. Treasury Bill. For FY 2003,

the LEQTF outperformed its legislative benchmarks and allocated \$51.9 million⁵ in additional funding for classroom computers, teacher training, matching grants and research at our universities.

In March 2002, the LEQTF invested \$10 million in the Louisiana Teachers Homebuyer Program through Fannie Mae. The program allowed qualifying Louisiana school teachers to receive home mortgages at a reduced market rate. This program was completed in FY 2003.

⁴ LEQTF Annual Report, June 30, 2003.

⁵ LEQTF Annual Report, June 30, 2003.



LOULEASE



Treasurer John Kennedy, Rep. Rosalind Peychaud, Vaughn Irons (Freddie Mac), Glenda Stevens (Home buyer), Congressman William "Bill" Jefferson, James W. Parks, II CEO-LPFA

The LouLease initiative reaches a segment of the population that has been previously denied homeownership opportunities.

Families who have experienced credit difficulties or who have never established a credit history will benefit most from this groundbreaking program. Owning a home is now more affordable, especially for those who may have otherwise been unable to qualify for traditional mortgages.

For more information visit www.loulease.org.

MEDICAID TRUST FUND FOR THE ELDERLY

The Medicaid Trust Fund for the Elderly has been described as "another windfall for Louisiana citizens." Treasury has worked closely with the Louisiana Department of Health and Hospitals (DHH) to implement an intergovernmental transfer program authorized by Act 143 of the First Extraordinary Session of 2000. The Medicaid Trust Fund received the first federal deposit in April 2001 in a net amount of \$306.6 million. The trust fund has continued to grow each year and has received over \$935 million in net federal receipts since its inception. During this time, Treasury has provided safekeeping and custody of the trust fund and has actively managed the investment of the fund to provide over \$60.6 million in investment earnings since inception. In FY 2003 alone, the trust fund received

over \$172 million, which included the final large net federal receipt of \$124.5 million and investment income of \$47.6 million.

The investment objectives of the Medicaid Trust Fund for the Elderly have been established in conjunction with the financial requirements of the fund. The main goals of the fund are preservation of capital and enhancement of market value while providing a stable and predictable income.

The fund's interest earnings are used as state matching dollars to obtain federal dollars for healthcare. To implement the program, Treasury, DHH and participating nursing homes entered into cooperative endeavor agreements.

RAINY DAY FUND

The Rainy Day Fund (Budget Stabilization Fund), approved by the voters as a 1998 constitutional amendment, provides for creating a savings account to meet future emergency funding needs. The cash balance in the Rainy Day Fund at the beginning of FY 2003 was \$266.2 million. The Rainy Day Fund grew by \$11.4 million during the fiscal year. This growth came from two sources—\$6.5 million in sources declared non-recurring by the Revenue Estimating Conference and \$4.8 million in investment income.

The objective is to grow the Rainy Day Fund to provide a means to stabilize recurring revenues each fiscal year to avoid budget cuts that adversely affect government services to the citizens of the state.

The state has experienced a decline in revenues insufficient to meet its expenditure needs in FY 2003. As a result, the Legislature approved the first time use of the Rainy Day Fund to inject \$86.4 million into the budget to help offset a shortfall in funding. The cash balance in the Rainy Day Fund at the end of FY 2003 was \$191.1 million.

Although a very useful fiscal management tool, Treasurer Kennedy is against tapping into the Rainy Day Fund too frequently. To reinforce the fund's original intent, he encourages the Legislature to pass a constitutional amendment that would limit access to the Rainy Day Fund to no more often than every other year, and then for emergencies only.

STATE RETIREMENT FUND

The Treasurer, by state statute, serves as an ex-officio voting member of each of the four state retirement system boards of directors. Those systems are the state teachers, state employees, state school employees and the state police. The combined assets of the four systems at the fiscal year ended June 30, 2003 were \$19.7 billion with a total

participating membership of 276,708. Each system has a board of trustees with a membership consisting of both elected representatives and ex-officio members. The board's elected members combine elected representatives of both active and retired memberships of each system.

RETIREMENT SECURITY

The Louisiana Department of the Treasury's Social Security Division is responsible for administering the Section 218 Social Security and Medicare coverage program for all public governmental employers throughout the State of Louisiana.

The Division serves as a facilitator between employers and the U.S. Social Security Administration (SSA) and Internal Revenue Service (IRS). The SSA and IRS are the two principal federal agencies responsible for coverage, benefits and tax withholding associated with Social Security and Medicare.

When the Social Security Act was enacted in 1935, public employees were not eligible for Social Security coverage. This was due to a constitutional question regarding the federal government's power to tax state and local governments. Consequently, many government employees were without a retirement plan.

Beginning in 1951, Section 218 of the Social Security Act authorized states to voluntarily elect Social Security coverage for certain public employees who were not already covered under a retirement plan. These federal-state agreements, often referred to as Section 218 agreements, were entered into with the Social Security Administration.

The Social Security Administration website is www.ssa.gov/slge. SSA provides the interpretations and rulings, the state agreement, and its modifications as they apply to the public employer.

The Internal Revenue Service website is www.irs.gov/govt. IRS is the federal government agency responsible for administering the internal revenue code, reporting requirements for Social Security and Medicare taxes, and auditing and collecting FICA taxes. Federal, state and local government experts assist in complying with federal employment tax laws and information return reporting.

The National Conference of State Social Security Administrators (NCSSSA) website is www.ncsssa.org. This group lends peer support, expertise and a forum for networking to the state Social Security administrators. The NCSSSA also provides a critical link between states, the SSA and IRS.

Treasurer Kennedy is an advocate for preserving public employee retirement plans, especially for those who are not covered under Social Security. Mandating public systems to participate in Social Security when they choose not to would jeopardize the financial stability of the systems and would adversely impact the benefits that the participants receive. Fourteen states, including Louisiana, have opted to cover substantial numbers of their employees under independent plans rather than Social Security. Most teachers, firefighters and police officers are covered by independent plans in lieu of Social Security.

These public employees will not be eligible for Social Security or Medicare benefits unless they have paid into Social Security elsewhere. Rather, they are dependent upon the solvency of the independent retirement plans that they have participated in as public employees during their working career.

If a public employee has paid into Social Security at some point in his or her life, there are currently two provisions in the Social Security program that adversely affect the receipt of benefits. The first is called the Windfall Elimination Program (WEP), which reduces Social Security benefits for people who have spent most of their careers in government but who have also worked in private industry. The other provision is called the Government Pension Offset (GPO), which reduces—and in some cases eliminates—the Social Security benefit due to a government employee as a spouse.

Bills have been introduced in Congress to repeal these provisions, and Treasurer Kennedy supports any federal

legislation that would eliminate or reduce the detrimental effects of the GPO and the WEP on retirees in Louisiana. Retirees who have worked hard for our state -- from school teachers to police officers -- are suffering under the current law. Social Security benefits statements do not calculate the GPO or WEP, and this leads government retirees to have higher pension expectations than they should. Sadly, most seniors cannot afford to have these expectations.

Treasurer Kennedy also supported federal legislation in Section 416 of H.R. 743 that added Louisiana to the list of states that can conduct divided referendums for Medicare coverage. Louisiana will need to pass enabling legislation this spring in order to offer this option to governmental employees.

Divided referendums help individual Louisiana public employees as well as their state and local government employers by providing an opportunity for "Medicare Only" coverage for employees hired prior to April 1, 1986. Current law requires that a majority of the eligible employees vote in favor of "Medicare Only" and all old hires must pay Medicare. The divided referendum enables employees who vote yes to pay Medicare and employees who vote no to not pay Medicare.

Louisiana could save millions of dollars by using divided referendums, when Medicare is primary and an employer's health insurance is secondary. The Treasury's Division of Social Security will be responsible for conducting each referendum at the request of the employers or the retirement systems.

For more information, visit www.latreasury.com.

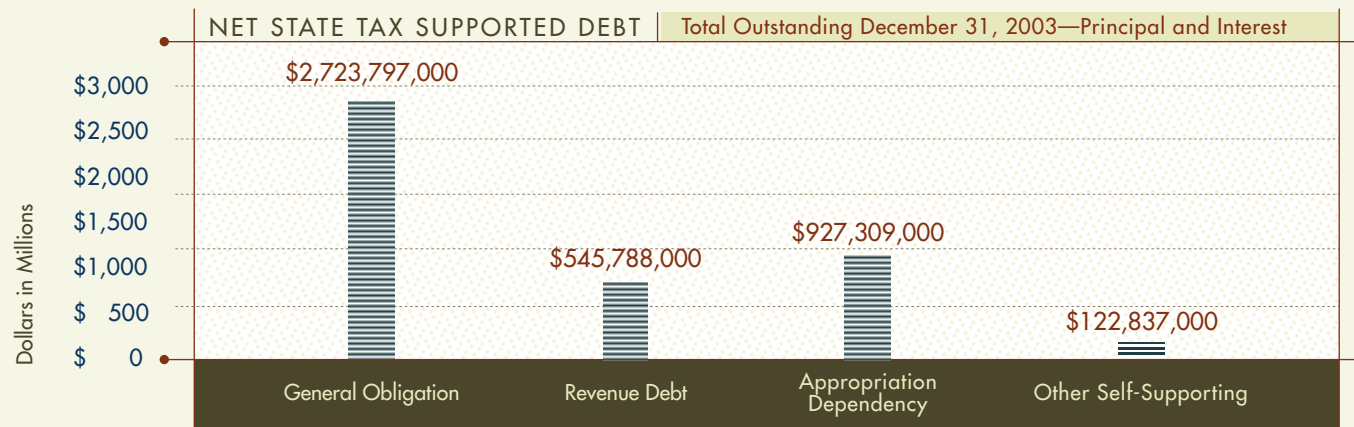
STATE CREDIT RATING AND DEBT

All three bond rating agencies raised the state's bond rating in 2003. Fitch revised the rating from "A" to "A+" stating that the change reflected the institutionalization of structural changes that strengthen the state's credit, including financial policies enhanced by the recent constitutional amendment, as well as debt reduction in recent years. Moody's improved

the state's bond rating from "A2" to "A1", citing the state's positive fiscal position during a period when state finances have been affected, conservative budget and debt management, and strong cash position. Standard and Poor's, which raised the rating from "A" to "A+" indicated the upgrade was due to improved financial and budgetary performance, prudent use

of the Rainy Day Fund and reduction in debt burden. This marked the first time in almost two years that Standard & Poor's had raised its rating on a state.

The following chart illustrates the categories included in the definition of Net State Tax Supported Debt, and the various types of debt included in each category.



Notes for Chart:

General Obligation includes General Obligation Bonds.

Revenue Debt includes Gasoline & Fuels Tax Revenue Bonds (series 1999 and Series 2002A)—payable solely from the proceeds of a four-cent per gallon gasoline tax.

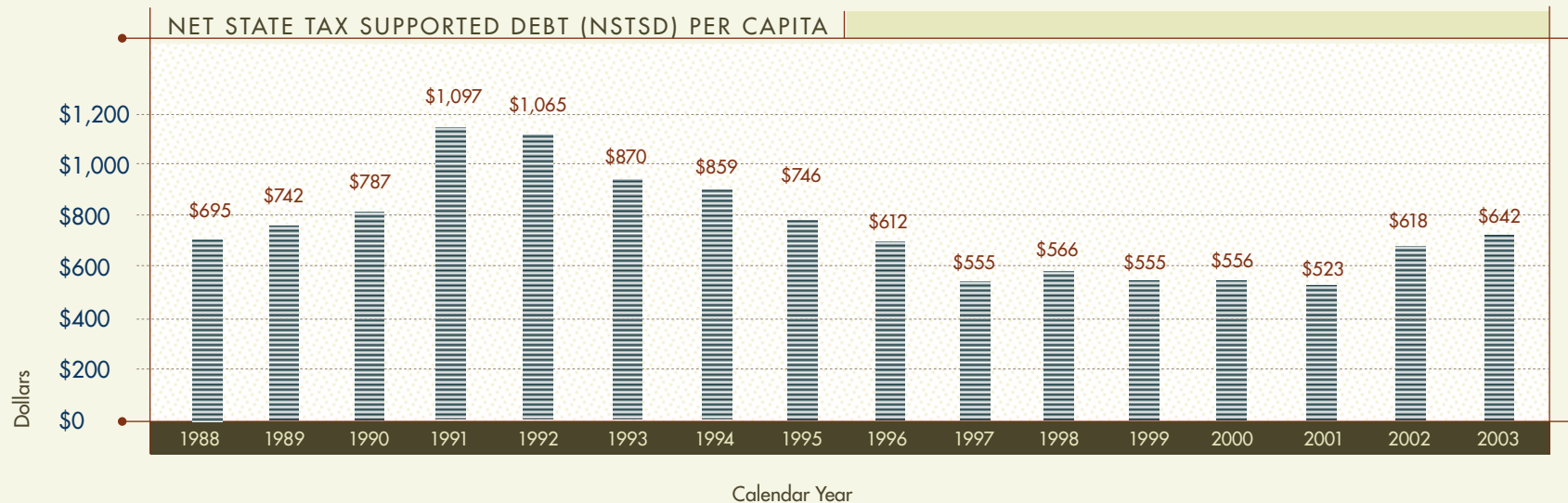
Appropriation Dependency Debt includes Office Facilities Corporation; LPFA Hotel Dieu, 2002; Louisiana Correctional Facilities Corporation, 2002; LPFA Public Safety JESTC, 2001; LPFA Public Safety Fire Marshall's Headquarters, 2002; LCDA Bossier Parish Community College; LCDA Baton Rouge Community College; South Louisiana Community College.

Other Self-Supporting Debt includes Crescent City Connection, Greater Baton Rouge Port Commission and Greater New Orleans Expressway Commission.

Source: Unaudited data from the Division of Administration.

STATE CREDIT RATING AND DEBT

The following chart depicts the amount of Net State Tax Supported Debt (NSTSD) Per Capita for calendar years 1988-2003:



In May, 2003, the state sold \$290,790,000 in General Obligation Bonds to finance capital outlay projects for various purposes including general government; elected officials; economic development; culture, recreation and tourism; transportation and development; corrections and public safety; health and hospitals; natural resources; wildlife and fisheries; education; judiciary and non-state entities. These bonds were sold competitively via the Internet at an overall cost of 3.824 percent.

Sometime in calendar year 2004, the state anticipates selling approximately \$250 million to \$300 million in General Obligation Bonds for a variety of capital needs through the same competitive process.

2003 Debt Defeasance

The State Bond Commission authorized on June 17, 2003 the defeasance of certain General Obligation Bonds utilizing \$95,394,807 in General Fund Undesignated Fund Balance from FY 2002 and a portion of the Mineral Audit Settlement Fund. The resulting cash flows allowed for the early payment of \$88,710,000 in bond principal and \$8,463.952 in bond interest. The due date and amounts were as follows: 2003-04, \$46,401,482; 2004-05, \$29,997,370; 2005-06, \$20,775,100.

TOBACCO BOND ISSUE



The Tobacco Settlement Financing Corporation, an independent special purpose public corporate entity, sold approximately \$1.2 billion tobacco settlement revenue bonds in October, 2001, secured by 60 percent of the revenues received by the state from the Master Tobacco Settlement Agreement ("TSA"). The money was placed in trust to benefit healthcare, education and the TOPS scholarship program. Additionally, a portion of the money went to Louisiana public school systems and to the state's operating budget for education and healthcare. The Millennium Trust Fund realized approximately \$39 million in estimated earnings in FY 2003.

The Legislature in 2003 passed Acts 1136 and 1192 permitting the state to securitize any remaining portion of

the revenues received from the TSA and transfer to the Louisiana Coastal Restoration Fund up to 20 percent of the revenues realized from the securitization, to be appropriated to the Department of Natural Resources for programs to reduce coastal erosion and restore areas of the state directly affected by coastal erosion.

But in FY 2003, the tobacco bond market had significantly deteriorated due to a number of state lawsuits against tobacco companies. However, early 2004 market conditions indicate more stability might be returning to the tobacco bond market for the near future.

THE E-TREASURY PROJECT



The Treasury uses technology to work smarter, faster and better for Louisiana citizens. The agency has undertaken a variety of projects using information technology and web-based services. These include:

Unclaimed Property

- Offering a web-based link exchange program with state universities to increase college students' awareness about the unclaimed property program (first quarter 2004).
- Notifying citizens via email when the unclaimed property database is updated.
- Translating the Treasury's unclaimed property website to Spanish and Cajun French (first quarter 2004) to better serve Louisiana citizens.

- Using database software to locate unclaimed property owners by cross-referencing the Treasury's current addresses with matches with motor vehicle registrations and driver's license records.
- Developing an interactive "Holder Reporting" module that will allow companies that have unclaimed property to upload an electronic report directly through the Louisiana Treasury's website making the process easier than ever.

Personal Financial Resources

- Adding identity theft resources online and working with the Bond Market Foundation to add personal financial management tools to Treasury's website during the first quarter of 2004.
- Accepting credit cards to make it easier for citizens to pay for state services, provide an alternative payment method that can reduce NSF checks to the state, and improve customer service by expanding payment options to the Internet.

State Bond Commission

- Employing web-based technology to bid out \$290.8 million in general obligation bonds at a record low interest rate of 3.8 percent. Proceeds from the online bond sale funded approved capital outlay projects for education, local governments, transportation, public safety and corrections, healthcare, and tourism, among other areas.
- Posting State Bond Commission agendas online and sending automatic updates of monthly Bond Commission activities via email.

Electronic Banking

- Treasury continues to assist state agencies to modernize their banking processes by implementing Internet-based agency to bank communications. This communications link allows state agencies to initiate online stop pays, wire transfers, Automated Clearing House debits and credits, and obtain statement information in a secure and accessible environment.
- Assisting the Governor and the Louisiana Office of Electronic Services to expand the Louisiana E-mail by adding the payment option of "electronic check" for funds owed to the state. The E-mail is the official one-stop shopping mall for Louisiana state services.
- Treasury has implemented the latest fraud preventive measures to protect against fraudulent check writing and electronic theft. "Positive Pay" provides the bank with check issue information so the bank can recognize fraudulent checks and "ACH Debit Block" prevents unauthorized debits to the state's accounts.

Online Publishing

- Publishing Treasury and LEQTF annual reports (both required by law) electronically, making the reports more cost-effective and more accessible to the public.

ONGOING INITIATIVES

In addition to the programs discussed in previous sections of this annual report, the Treasury is also working on the following initiatives:

Tobacco Settlement Sale

- Treasurer Kennedy will work with the Legislature and the governor to decide when and if the state should sell the remaining 40 percent of the state's tobacco settlement. There is approximately \$1.5 billion (dollars not adjusted for inflation) in payments still remaining over the life of the settlement, and Louisiana citizens voted for a constitutional amendment to dedicate a portion of a second tobacco sale to coastal erosion in the state.
- Treasurer Kennedy does not advocate selling the remainder of the state's tobacco settlement unless market conditions are conducive to a solid price for the state and all sale proceeds in addition to coastal erosion monies are placed into trust.

State Trust Funds

- Treasurer Kennedy continues to look for ways to maximize the returns on state trust fund investments.

Cash Management Review Program

- The Treasury has aided the Department of Wildlife and Fisheries in developing lockbox procedures that will save taxpayers money by improving their deposit practices.
- The Department of Health and Hospitals is already using a lockbox program.
- The Treasury's Cash Management Review Division conducted reviews of other state agencies in an effort to learn ways state government can save money when providing basic services to citizens.

- Treasurer Kennedy also wants to use the Treasury's Cash Management Review Division to help state agencies do a better job of collecting debts like outstanding fines and unpaid fees.

Substitute Teaching

- Treasurer Kennedy traveled the state to promote the creation of the Teach to Serve Program. The program would require elected officials to substitute teach without pay three times a year in a public school. Many officials in state government discuss the state's public school system and make decisions that impact elementary and secondary education. Teach to Serve would give them first-hand knowledge about what goes on in Louisiana's classrooms.
- Treasurer Kennedy hopes to aid in passing legislation this spring to create the Teach to Serve Program.

Earned Income Tax Credit

- Treasurer Kennedy started a public awareness campaign in February 2004 to promote the federal Earned Income Tax Credit. The credit, commonly known as the EITC, is one of the most important tax breaks available for hard-working families in the state.
- According to IRS statistics, 476,862 Louisiana citizens took advantage of the EITC on their tax returns for tax year 2001 and 470,886 for tax year 2000. Of those who file for the EITC, the average annual credit is nearly \$2,000. It is estimated that nearly 500,000 Louisiana citizens will qualify this year. Unfortunately, more than 93,000 Louisiana citizens did not take advantage of the EITC in tax year 2001, missing out on more than \$81 million in tax credits.

Louisiana Teacher Homebuyer Program

- Treasurer Kennedy is looking for new funds for a second Louisiana Teacher Homebuyer Program. The Treasury's first teacher homeownership initiative in 2002 allocated \$10 million in low-interest teacher home loans to 84 teachers statewide in just three days.

New Banking Technology

- Treasury is currently assisting state agencies to implement electronic banking technologies that will improve their receipt and payment processes. Examples include:
 - (a) Treasury is working with hospitals to develop easy ways for eligible workers with disabilities to pay premiums for Medicaid health care coverage;
 - (b) Treasury will be making available electronic banking procedures to assist the State Employees Group Benefits Program to collect premiums for retirees who are working after retirement;
 - (c) Treasury is working with Department of Public Safety in their efforts to convert to a new computer system by automating the accounting for the 175-200 daily deposit tickets prepared by the motor vehicle offices throughout the state;
 - (d) The Department of Social Services is responsible for collecting child support from "deadbeat" parents on behalf of the custodial parents. Treasury is working with the Department of Social Services to offer more convenient methods of transferring those collections to the custodial parents.

CORPORATE SCANDALS / FRAUD

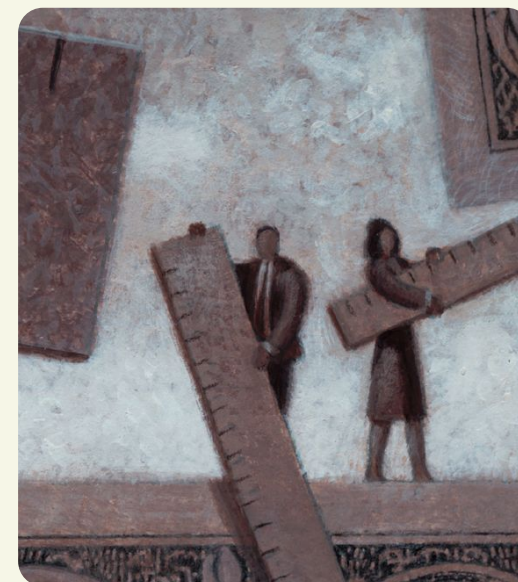
FY 2003 was saturated with news articles about Wall Street investment firms in trouble. Allegations of wrongdoing flooded the industry, and mutual fund managers are the latest group hit for improper business practices.

State trust fund investments and savings in the Student Tuition and Revenue Trust (START) 529 Plan have not been touched by these scandals. START, in particular, has had no exposure to the mutual fund industry, because investments have been focused strictly in a fixed income portfolio of government bonds, notes and certificates of deposit.

Treasurer Kennedy is working with the National Association of State Treasurers (NAST) to put a halt to faulty business practices in the investment industry. He joined NAST in passing four resolutions urging stricter guidelines on investment firms and enhancing corporate governance in order to protect

individual investors. The resolutions call for companies to give active attention to increasing the importance of shareholders in American corporations and urge all institutional investors, including all state and local public fund investors, to exercise their full fiduciary responsibilities by adopting and actively enforcing the Investor Protection Principles as central to their investment management practices, procedures, rules and regulations. NAST is also asking corporations to report stock options the same year they are granted and to end the financial incentives for American corporations that re-incorporate overseas.

The investment climate is constantly changing, but one thing remains the same. The Treasury will continue to manage its investments to earn the highest return possible with the least amount of risk.



START

The Treasury manages investments in the state's 529 plan, also known as the Student Tuition and Revenue Trust (START). The Treasury invests START funds to help parents and other individuals who want to save money for a child's expenses at any approved university, vocational-technical school or community college.

START is tax-free, and individuals can exempt up to \$2,400 in deposits per account per year from income reported on their state tax returns. If an individual does not take the full \$2,400 in one year, he or she can carry unused portions forward to subsequent years.

START offers a competitive rate of return on its fixed income

investments and provides state matches on most contributions. In calendar year 2003, START earned a rate of return of 5.33 percent and earned the highest rate of return of states reporting earnings for the first half of 2002.

START closed the year with \$37.5 million in total assets, \$36.4 million in total contributions and 11,545 active accounts.

START / Babymint / Vanguard

START continues its relationship with the BabyMint network—a microinvestment technology firm that automatically deposits cash rebates into 529 plans when participants shop at selected retailers. The partnership will

assist START account owners in reaching their college savings goals when they shop at any of the more than 700 merchants and 127,000 grocery stores contained within the BabyMint retail network.

Beginning in February 2004, the Treasury will continue to manage fixed income investments for START, and The Vanguard Group will manage accounts invested partially or completely in stocks.

START's Equity Options Include:

Option 1: Age-Based Option

- Vanguard LifeStrategy Moderate Growth Portfolio (Age 0-5)
- Vanguard LifeStrategy Conservative Growth Portfolio (Age 6-10)
- Vanguard LifeStrategy Income Portfolio (Age 11-15)
- Louisiana Fixed-Return Portfolio (Age 16+)

Option 2: Louisiana Principal Protection Option

- 100% Louisiana Fixed-Return Portfolio

Option 3: Total Equity Option

- 100% Vanguard Total Stock Market Index Portfolio

Option 4: Balanced Option

- 50% Fixed Income Investments and 50% Stocks

Option 5: Equity-Plus Option

- 75% Stocks and 25% Fixed Income Investments

Option 6: Principal Preservation Plus Option

- 75% Fixed Income Investments and 25% Stocks

More information is available by contacting the Treasury's Investments Division at (225) 342-0020 or by visiting Treasury's website.

BID LOUISIANA

By law, the Treasury can competitively bid out 20 percent of state funds determined available for certificates of deposit (CD) investment. Using an Internet auction system called Bid Louisiana, the Treasury awards cash to a bank with the highest bid in exchange for a CD. The bank then uses that cash and lends it out to customers. The Treasury's CD, in return, is like a promissory note the bank pays back over time with interest.

Bid Louisiana holds quarterly auctions each year. By using an online bidding system to auction CDs, the Treasury has earned more than \$92,000 in additional earnings for the state this past fiscal year.

CDs are a win-win situation for both the state and banks. The state invests in CDs because they are widely accepted fixed income investments that are relatively safe. Banks win because they get cash up front they can lend out to individuals or use in other ways, ultimately for the benefit of the community where they're located.

Louisiana banks can access CDs using the Treasury's online competitive auction, located at **www.bidlouisiana.com**. Information on CDs can also be obtained by contacting the Treasury directly at (225) 342-0010.

LAMP

The Louisiana Asset Management Pool (LAMP) is a cooperative endeavor that combines the efficiency of private enterprise with the protection of public policy. LAMP is managed by LAMP, Inc., a non-profit corporation that allows local officials to pool public funds and benefit from money management dedicated to preservation of principal, daily liquidity and a competitive rate of return. Treasurer Kennedy serves as President of the LAMP, Inc. Board of Directors.

At the end of the year, LAMP had 493 participants. LAMP continues to earn a Standard & Poor's rating of AAA, the highest designation available. It also has enhanced its program by hiring a new record keeper and transfer agent and adding three Louisiana investment managers to manage a portion of the fund.

For more information, visit LAMP's website at **www.lamppool.com**.

ECONOMIC EDUCATION

College Savings Month

For the third year in a row, Treasurer Kennedy held College Savings Month in September to promote START. In FY 2003, Louisiana was among 40 states that participated in the annual public awareness campaign. Treasurer Kennedy considers START to be one of the best 529 plans in the nation.

Jump\$tart Coalition for Personal Financial Literacy

Treasurer Kennedy continues to be an active member and supporter of the Jump\$tart Coalition for Personal Financial Literacy. The coalition is made up of individuals from the private and public sectors who come together to support personal financial literacy for students and citizens in Louisiana.

Financial Literacy Legislation

Act 296 of the 2003 Regular Legislative Session amended the free enterprise curriculum in public schools to include personal

finance instruction. Louisiana high schools will use a nationally-recognized program that has an 86 percent success rate in providing students with a better understanding of finances and money. Students will now learn to manage their finances, use credit wisely, and develop savings plans.

Bank at School

Bank at School is a cooperative effort between the Treasury and the Louisiana Young Bankers Association. The program encourages elementary school students to open savings accounts at school with a minimum deposit of 50 cents.

Once the Treasury and elementary schools open banks at schools, teachers give monthly lessons on money management. Throughout the school year, Treasury staff participates in as many Bank at School grand opening ceremonies as possible.



CONCLUSION


This past fiscal year has been one of ups and downs in the investment market. Corporate scandals, investment fraud, and a lagging economy have taken their toll on institutional and individual investments. The state, however, has fared relatively well in the shaky market, because we have made smart decisions.

One thing that makes me the most proud was our decision to place our tobacco sale proceeds into trust. While we watched state after state raid their tobacco settlements to balance their budgets this fiscal year, we watched our tobacco trust grow and earn more money for education and healthcare in our state.

Things are looking up, and at the close of the year, we are seeing signs of an economic upswing. The NASDAQ topped 2,000, jobless claims continue to decline, and the stock market has been in a nearly year long recovery.

We at Treasury have faced the obstacles the investment market has thrown at us head-on this fiscal year, and we are ready for the challenges ahead. Another year lies ahead of us, and there is still plenty of work to do for Louisiana citizens.

As always, it is a pleasure serving you.



John Kennedy

State Treasurer



The Louisiana Department of the Treasury recognizes the importance of protecting Louisiana's coastline and wetlands, and it supports the America's Wetland campaign.

STAFF CONTACTS

Please feel free to contact any of my staff members if we can be of assistance to you.

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Executive Counsel	James Napper	(225) 342-0029
Chief Financial Officer	Gary Hall	(225) 342-0051
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Communications Director	Sarah Mulhearn	(225) 342-0012
Policy and Research Director	Jason Stagg	(225) 342-0006
Human Resources Director	Lynette Mack	(225) 342-0030
Social Security Division Director	Linda Yelverton	(225) 342-0026
Internal Auditor	Donald R. Ford	(225) 342-0009
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